KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2012-00520
POST HEARING DATA REQUESTS FOR CARL MEYERS

Question 1:

Is it correct that the FIN 48 reserve is a reclassification of the deferred tax liability for expenditures deducted for tax purposes for which Kentucky-American Water Company and American Water Works Company are of the opinion that is less likely than not to be accepted by the Internal Revenue Service?

Response:

Yes, the FIN 48 reserve related to repairs is a reclassification of the deferred tax liability for expenditures deducted for tax purposes, and capitalized for book purposes, for which Kentucky-American Water Company and American Water Works Company believe less likely than not to be accepted by the Internal Revenue Service.

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Question 2:

a. What decreases to forecasted test-period expenses have occurred as a result of the aggressive tax position taken by Kentucky-American Water Company and American Water Works Company?

b. What reductions to rate base accounts have occurred as a result of the aggressive tax position taken by Kentucky-American Water Company and American Water Works Company?

c. If specific benefits cannot be identified or quantified, how do Kentucky-American Water Company ratepayers benefit from the aggressive tax accounting treatment?

Response:

a. Total tax expense is not affected by the aggressive tax position, related to repairs, taken by Kentucky-American Water Company. It decreases current tax expense and increases deferred tax expense by the same amount. The repairs deduction is a timing difference.

b. Rate base is reduced by the repairs deduction (aggressive tax position) because the deduction creates an additional deferred tax liability. A FIN 48 reserve is established on the deduction, which reduces the deferred tax liability and moves it to a long term liability. As of 09/30/2012, the net increase to deferred taxes as shown on the ledger (and therefore reduction to rate base) was $10,964,593. An additional net amount of $2,005,009 is applicable for the forecasted test period for a total of $12,969,602 reduction to rate base as of 07/31/2014.

c. Kentucky-American Water Company ratepayers do receive specific benefits as identified in parts a and b of this same request for information.

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Question 3:

a. If Kentucky-American Water Company and American Water Works Company took a less aggressive tax accounting approach for the expenditures in question, how would Kentucky-American Water Company and American Water Works Company account for these expenditures?

b. Would the expenditures be capitalized and depreciated at an accelerated rate for tax purposes and result in deferred tax liability?

c. Can you provide a calculation of the deferred tax liability that would have resulted in the capitalization of all expenditures that have created the current FIN 48 reserve and the effects of this deferred tax liability on the requested revenue requirement? If yes, please provide.

Response:

a. The accounting would be the same for the repairs deduction and FIN 48 reserve. A less aggressive approach may not create as large a deferred tax liability and reduction to rate base. The FIN 48 reserve amount would most likely be less also, but it would not be eliminated.

b. Yes.

c. The calculation requested is how the Company's FIN 48 reserve is currently recorded. The deferred tax liability is reduced by the FIN 48 reserve. But each year the FIN 48 reserve is reduced for any tax depreciation that the Company would receive if the IRS disallowed the whole repairs deduction.

Please refer to the attachment to Item 11 of the Hearing Data Requests. For each year, see the Recoverable Depreciation columns. This is the depreciation that the Company would get if the repairs deduction was reduced by the reserve.